EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI				
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/Pers				
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
19	NIO/ECON	X			
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SUSPENSE ______________
Date

Remarks

STAT

Executive Secretary

30 Jan 85
Date

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THE WHITE HOUSE
WASHINGTON

Executive Registry
85- 438

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 1/30/85 **Number:** 169127CA **Due By:**

Subject: Joint CCCT/TPC Planning Meeting - Thursday, January 31, 1985
3:15 P.M. - Roosevelt Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☑	☐
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☑	☐
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☑	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
	☐	☐
	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☑	☐
Chapman	☐	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
Executive Secretary for:		
CCCT	☑	☐
CCEA	☐	☐
CCFA	☐	☐
CCHR	☐	☐
CCLP	☐	☐
CCMA	☐	☐
CCNRE	☐	☐

REMARKS:

There will be a joint meeting of the Cabinet Council on Commerce and Trade and the Trade Policy Committee on Thursday, January 31, at 3:15 P.M. in the Roosevelt Room.

The agenda is the "State of the U.S. Automobile Industry." A background paper is attached.

DCI EXEC REG

RETURN TO:

☐ Craig L. Fuller
Assistant to the President

☐ Don Clarey ☐ Tom Gibson ☑ Larry Herbolsheimer
Associate Director
abinet Affairs

L-300C

SECRETARY OF COMMERCE
Washington, D.C. 20230

January 29, 1985

MEMORANDUM FOR Cabinet Council on Commerce and Trade

FROM: MB Malcolm Baldrige
Chairman Pro Tempore

SUBJECT: State of the U.S. Automobile Industry

Attached for your use at the joint CCCT/TPC meeting of January 31, 1985, is the Commerce Department staff analysis of the state of the U.S. automobile industry in 1983.

SUMMARY

Condition of the U.S. Auto Industry

In 1984 U.S. manufacturers sold an estimated 11.5 million motor vehicles (7.95 million cars, 3.5 million trucks), 22.3 percent above sales in 1983. Production increased about 18.5 percent. At the end of 1984, total auto industry employment was estimated to be about 880,000 with about 50,000 workers still on indefinite layoff.

As of September 30, 1984 the financial condition of the U.S. auto companies was at its best level since 1978. The U.S. companies have largely recovered from the recession and are in much stronger financial shape. In both 1983 and 1984, the companies earned record profits. As of the end of September 1984, industry profits stood at $7.6 billion, far above the $6.2 billion they earned for the full-year 1983. The industry is expected to report full-year 1984 income of around $10 billion. In constant 1978 dollars, this figure would be $6.3 billion, well above the 1978 level of $4.9 billion.

An examination of industry financial statements as of September 30, 1984, shows that the company balance sheets have not returned to 1978 levels. However, due to changes in the basic financial and operating structure of the industry since the late 1970s, they may never do so. For example, the industry has implemented aggressive working capital management programs designed to reduce receivables and inventories (the "just-in-time" system), while stretching payables. This program reduces liquidity, but increases cash flows.

Balance sheet leverage, though higher than in 1978, is low compared with most industries, and continues to improve. Barring radical increases in Japanese market share, combined with a severe recession, cash flows should be sufficient to finance capital expenditures, debt repayment, and dividends without substantial borrowing. (Possible exceptions are Chrysler, whose 1985 tax liability may squeeze its cash flow, and AMC, whose earnings are still modest).

Controlled By: Watkins
Deputy Asst. Secretary for
Automotive Affairs and Consumer Goods
Decontrol On: OADR

Approved For Release 2009/10/19 : CIA-RDP87M00539R002303850004-4

Auto Industry Sales, Production and Employment

Sales of automobiles continued to recover strongly in 1984, increasing 13.2 percent over 1983 sales. Domestic car sales were up 17.0 percent to 7.95 million units, and import sales were up 2.2 percent to 2.44 million units in 1984. Japanese cars sales declined 0.5 percent in 1984 to 1.91 million units. Import penetration declined from 26.0 percent in 1983 to 23.5 percent in 1984. Japanese market share fell from 20.9 percent in 1983 to 18.5 percent in 1984 because of the restraint and the strength of the domestic car market.

Domestic auto production rose 14.5 percent in 1984 over 1983, totaling 7.76 million units in 1984. Industry employment rose substantially, from an average of 757,800 in 1983 to an estimated average of 866,000 in 1984. While this is a considerable improvement, total industry employment is still well below the 1978 peak of 1.03 million workers. Productivity improvement, illustrated by a 14.5 percent increase in 1984 production with only a 5.3 percent employment increase, suggests no return to 1978 employment levels.

Financial Condition

The financial condition of U.S. automobile manufacturers at the end of 1984 was at its best level in several years. Most of the companies' 1984 profitability indicators exceeded those of both 1983, a highly profitable recovery year, and 1978, the last good year prior to the recession. Higher earnings led to correspondingly greater cash flows in 1983 and 1984. Balance sheet indicators improved steadily following the recession, but remained below most 1978 levels as of September 30, 1984.

The cumulative effects of years of low earnings, losses, and large borrowings to finance huge capital outlays are still evident when examining balance sheets. For example, neither balance sheet leverage nor liquidity has returned to 1978 levels. These factors, together with heightened foreign competition, are the principal reasons the chief debt rating agencies (i.e., Moody's and Standard & Poor's) have not restored fully the 1978 ratings.

Table I

Senior Long-Term Debt Ratings

	Moody's		Standard & Poor's	
	1978	1984	1978	1984
GM	Aaa	Aa2	AAA	AA+
Ford	Aaa	A1	AAA	A-
Chrysler	Baa	Baa3	BBB	BBB

management, and the product mix shift have enabled the companies to widen their margins above those of 1978--on slightly lower volume. The industry's operating profit margin was 7.10 percent in 1978, compared with 7.17 percent for the first 3 quarters of 1984. The 1984 amount would have been higher had GM's margin not deteriorated. GM experienced parts problems with new front-wheel-drive models, production disruptions related to model changes, and the loss of one week's production due to the UAW strike. These factors also caused GM's operating profit to fall below that of 1978.

Return on sales rose from 4.03 percent in 1978 to 6.38 percent for the first 3 quarters of 1984, reflecting the aforementioned improvements and substantially increased earnings from unconsolidated subsidiaries (primarily finance companies). Unconsolidated earnings tripled between 1978 and 1984, as banks, long the main source of financing of retail purchases, retreated from the market during the downturn of 1980-1982. Finance companies filled the gap and experienced rapid growth in their receivables volume and net interest income.

Cash Flow

Chiefly because of record earnings, the auto companies' internal cash generating ability was very strong in 1983 and 1984. Internally generated cash (cash from operations) was $12.3 billion for the first 9 months of 1984, while the year-earlier amount was $8.9 billion. The full-year 1984 figure should exceed $16 billion, compared with $15.4 billion for full-year 1983. When compared with 1978, the companies' ability to generate cash internally to cover capital expenditures, debt repayments and dividends rose. The ratio of cash from operations to capital expenditures, net long-term debt repayments, and dividends climbed from 1.04 for full-year 1978 to 1.43 for full-year 1983 before dropping slightly to 1.32 for the first 9 months of 1984.

This improvement belies some important developments. First, dividends were low by historical standards in 1983 and 1984. The dividend payout rate dropped to 18.5% as of September 30, 1984, compared with 44.8% for 1978. Second, capital expenditures were low in 1983 compared with 1978, as the industry reached a trough in its capital investment cycle. The ratio of capital investment to sales was 5.8% in 1983, versus 6.4% in 1978. At the same time, however, debt repayments increased in 1983 and 1984, as the companies' stronger cash flows enabled them to reduce significantly the borrowings incurred between 1980 and 1982.

Future cash flows should continue to be strong although capital expenditures and dividends, which are expected to increase rapidly starting in 1985, might preclude continued accumulation of large cash balances.

Balance Sheet

Table III

Balance Sheet Indicators: U.S. Big Four

	December 31		September 30	
	1978	1983	1983	1984
Working Capital	$12,270	$5,700	$2,633	$9,011
Current Ratio	1.55	1.19	1.09	1.27
Quick Ratio	0.77	0.70	0.55	0.81
Long-Term Debt-to Equity Ratio	0.11	0.25	0.27	0.16

The companies' balance sheets have strengthened considerably since the recession, but they have still not returned to 1978 levels. Balance sheet leverage, as measured by the ratio of long-term debt to stockholders' equity (common and preferred stock, retained earnings, and foreign exchange adjustment), improved from .25 on December 31, 1983 to .16 on September 30, 1984, but was still above that of December 31, 1978--.11. While the companies' excellent cash flows permitted them to repay large blocks of debt, owners' equity (though sizeable) was lower than it would have been because of cumulative losses and low earnings between 1979 and 1982. Owners' equity was also adversely affected by the strength of the dollar, which reduced the value of foreign assets and earnings when consolidated with American operations. Additionally, fourth quarter 1984 owners' equity growth was adversely affected by recent stock repurchases by Ford and Chrysler.

Liquidity followed a pattern similar to that of leverage. Working capital rose from $5.7 billion at the end of 1983 to $9.0 billion on September 30, 1984; it was $12.3 billion at the end of 1978. Chrysler's working capital was negative on September 30, 1984. The current ratio (current assets/current liabilities) has also improved, but at 1.27 on September 30, 1984, it was still below the 1.55 level on December 31, 1978. Part of the drop in liquidity resulted from the advent of "just-in-time" inventories. However, much of the reduction also arose from the effects of the recession during which companies stretched payables and accrued liabilities while reducing receivables in order to strengthen cash flow.

The quick ratio, which is the companies' most liquid assets (cash, marketable securities, and receivables) divided by current liabilities, exceeded the 1978 level. It grew from .77 at the end of 1978 to .81 on September 30, 1984. As noted earlier, the industry's strong cash flows were the primary cause of the buildup, and should help the industry weather the next cyclical downturn. However, even this rapid cash buildup was not enough to restore entirely working capital and the current ratio to 1978 levels.